Commentary

Cash For Clunkers: Home Edition

Doug Bandow 12.28.09, 12:00 PM ET

Cash for Clunkers (cars) is over. Cash for Clunkers (houses) continues. Legislators just extended the scandal-marred $8,000 home- buyer tax credit--which means another $11 billion will be wasted.

Ground zero of last year's financial crash was the politically driven collapse in the housing market. Six years ago, Rep. Barney Frank, now chairman of the House Financial Services Committee, declared: "I want to roll the dice a little bit more in this situation towards subsidized housing."

Uncle Sam rolled the dice a lot, and we all are paying the bill.

So far the home-buyer tax credit has cost $10 billion. As few as one-fifth of those taking the credit really were new buyers, which Steven Pearlstein of the *Washington Post* figured meant a $75,000 subsidy per new house sold. When Congress nevertheless renewed the credit, it also expanded the benefit to owners for up to five years, and raised income eligibility.

However, the credit is barely a rounding error compared with continuing losses by Fannie Mae and Freddie Mac. These two "government-sponsored enterprises" (GSEs) promoted both subprime lending and mortgage securitization, which turned bad mortgages into bad securities.

Today Fannie and Freddie underwrite $5.4 trillion worth of private home mortgages. Yet Washington is keeping the GSEs busier than ever. In October, Secretary Timothy Geithner advocated "a one-year extension of the current loan limits" to help "support the continued availability of affordable mortgages for many working families and aiding the recovery in the housing markets."

In early-November, Fannie Mae announced a third-quarter loss of $19 billion, making $102 billion in losses over the last two years. Fannie requested another $15 billion in taxpayer aid--on top of $45 billion already provided.

Freddie Mac lost "only" $6.3 billion in the third quarter, but overall has been an even bigger financial black hole, dropping $121 billion over the last 14 months. So far it has consumed $51 billion in taxpayer cash, and said that it will also ask for more taxpayer help.

The FHA insured more than $360 billion worth of mortgages over the last year, twice the amount in 2008 and four times as much as the year before. The Bush administration expanded the program's loan limits, further fueling the housing bubble.

Today the FHA is requiring just a 3.5% down payment--a fraction of that demanded by most lenders. Last year, Congress temporarily raised the loan limit to $729,750; Rep. Frank wants to hike it further and make it permanent.

The FHA's share of new loans went from 2.7% in 2006 to 23% earlier this year, and the agency moved from moderate- to high-priced cities. One young San Francisco borrower told *The New York Times* that "It was kind of crazy we could get this big a loan."

Unfortunately, FHA capital reserves have fallen to .53%, well under the congressionally mandated 2%. Defaults on FHA-backed loans are now 8.3%, up from 6.1% a year ago. A fifth of agency-guaranteed loans are considered to be "seriously delinquent." At the same time, the Housing and Urban Development Inspector General warns that FHA oversight resources are inadequate, but administration officials say no worries. Under pressure, the FHA has proposed raising capital standards and credit scores. Still, FHA Commissioner David Stevens warns against the temptation to "overcorrect."

Then there is the Government National Mortgage Association, or Ginnie Mae, which is expanding its issuance of guaranteed mortgage-backed securities. The organization is backing 27 mortgage companies "with a history of reckless lending, fines or other sanctions by state and federal regulators or civil lawsuits," according to the *Washington Post*. Yet in June Ginnie Mae issued a monthly record of $43 billion--"phenomenal growth," in the words of Ginnie Mae. Financial exposure is expected to rise from $577 billion last year to $1 trillion by the end of next year.

Worse is the Community Reinvestment Act. The legislation, enacted in 1977 and tightened during the Clinton years, was used by ACORN and similar groups to extort money from banks seeking merger approval. More important, CRA pressed banks to make loans to unqualified borrowers.

CRA commitments currently exceed $6 trillion (compared with just $9 billion between 1977 and 1991). Edward Pinto reports in *City Journal* that CRA loans "constitute toxic lending--that is, lending that leads to unsustainable loans, resulting in an unacceptable level of foreclosures."

Yet Congress is considering expanding CRA to credit unions, insurance companies and mortgage lenders. The administration has yet to take a position on the legislation, but declared that "rigorous application of the Community Reinvestment Act should be a core function of" its proposed Consumer Financial Protection Agency.

To some policymakers, bad loans are a small price to pay for spreading federal largesse far and wide. Said Rep. Frank: "I don't think it's a bad thing that the bad loans occurred. It was an effort to keep prices from falling too fast."

Disentangling the government from housing has become increasingly difficult. The Federal Reserve has purchased $836 billion in debt issued or guaranteed by the GSEs, on the way to a planned total of $1.25 trillion. Today Uncle Sam funds or guarantees roughly 86% of new home loans, nearly a three-fold increase in just four years.

Even this isn't enough for Washington. The Department of Agriculture has a special residential subsidy program, which is running "only" $10.5 billion this year, treble the level of 2007. So far delinquency and default rates are low, but the dramatic expansion of lending is a prescription for failure. Michael R. Widner of Stifel Nicolaus Equity Research warned: "If you are getting massive growth, you are probably getting a good number of the wrong people."

And Rep. Frank has joined with Rep. Maxine Waters, D-Calif., to advocate giving billions of TARP money to the jobless for mortgage relief and local governments to buy foreclosed properties. Legislators also are complaining about banks not giving adequate mortgage relief: Rep. Al Green, D-Texas, warns that Congress may feel forced "to take drastic action." The Obama administration has threatened to punish lenders that do not aid distressed homeowners.

All of these programs are directed at residential housing. What will politicians do if the commercial real estate market collapses, as some analysts predict? Fannie and Freddie again are at risk, having jumped into apartment lending just as the commercial real estate market peaked. Mike Kelly, president of Calder Asset Management, observed: "Fannie basically put more gas on the fire."

Policymakers set the U.S. on course for an economic crash when they pumped up the housing market. Market fundamentals remain negative, causing Congress to propose a new round of subsidies. Having failed to learn from history, Washington appears bound to repeat its past mistakes.

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